

Unrelated income; social club; losses from nonprofit activity. A social club operates a food and beverage concession catering to nonmembers and has consistently sold the food and beverages at prices insufficient to recover the cost of sales. The club may not, in determining its unrelated business taxable income, reduce its net investment income by the losses from these sales to nonmembers.

ISSUE

May a social club described in section 501(c)(7) of the Internal Revenue Code, in determining its unrelated business taxable income under section 512(a)(3)(A), deduct from its net investment income its losses incurred on sales of food and beverage to nonmembers under the circumstances described below?

FACTS

The social club has unrelated business taxable income within the meaning of section 512(a)(3)(A) of the Code from investments made for profit. Also, it sells food and beverage to nonmembers at prices insufficient to recover the costs of such sales. The club's sales of food and beverages to nonmembers have consistently over a number of years resulted only in losses, and there is every indication that such sales to nonmembers will continue to result in losses for the club. The nonmembers are not guests of members under the guidelines of Rev. Proc. 71-17, 1971-1 C.B. 683.

LAW AND ANALYSIS

Section 512(a)(3)(A) of the Code provides in pertinent part that the unrelated business taxable income of an organization described in section 501(c)(7) means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 of the Code which are directly connected with the production of the gross income (excluding exempt function income).

Section 162 of Chapter 1 of the Code permits the deduction of all ordinary and necessary expenses incurred in carrying on any trade or business.

An activity lacking a profit motivation, whether conducted by an exempt nonprofit organization or a profit-making concern, does not constitute a trade or business for purposes of the deduction of expenses under section 162 of the Code. See *Iowa State University of Science and Technology v. United States*, 500 F.2d 508 (Ct. Cl. 1974), which follows the principle that an exempt organization (in that case a university exempt under section 501(c)(3)) may not offset net losses derived from a nonprofit activity (the operation of two noncommercial radio

stations) against income derived from a for-profit unrelated business (a commercial television station).

The social club's sales of food and beverages to nonmembers are not profit motivated because its prices are insufficient to recover costs. As a result, the organization has consistently had, and will apparently continue to have, only losses from its sales to nonmembers.

HOLDING

Because the sales to nonmembers are not profit motivated, the social club may not, in determining its unrelated business taxable income under section 512 of the Code, deduct from its net investment income its losses from such sales to nonmembers.